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Foreign Activity

AN ANALYSIS OF FOREIGN PARTICIPATION IN U. S. EQUITIES MARKETS
by the SIA Research Department

Volume II No. 3 September 25, 1979

FOREIGN ACTIVITY IN U.S. SECURITIES

HIGHLIGHTS

1. Net purchases of U.S. equities by foreign investors dropped 50%, from $684 million in the first quarter to $342 million in the second.

2. Asian investors as a group, and Japanese and Mideast investors, particularly, reduced their net purchases of U.S. equities by over 65% from the first quarter to the second.

3. Gross transactions by foreign investors in U.S. equities increased from $8.7 billion in the first quarter of 1979 to $9.7 billion in the second, with European and Canadian investors accounting for the bulk of this increase. Swiss investors increased their gross activity by 40% over this time.

4. For the first time since the second quarter of 1978, foreign investors were net sellers of U.S. Treasury bonds and notes, albeit a marginal $36 million. Although West German investors increased their net purchases substantially from the previous quarter and Swiss investors shifted from net sellers to net purchasers, Japanese investors reduced their net purchases of U.S. Treasury bonds and notes by $890 million from the first to the second quarter of 1979.

5. Net purchases of U.S. corporate bonds amounted to $279 million in the second quarter of 1979, up from the first quarter net purchase figure of $103 million but down compared to 1978's fourth quarter figure of $328 million.

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INTRODUCTION

Investments by foreigners in dollar-denominated instruments are closely linked to the outlook for the dollar in international currency markets. Increasingly, the relative values of the major currencies, including the dollar, are influenced by two variables: the quantities of oil currently imported from OPEC countries, both as a percentage of total oil consumed and in absolute terms; and, the capacities of countries to directly limit imports of oil through development of alternative sources of energy. While other factors are contributing to the current high levels of inflation experienced by most industrialized countries, the price of imported oil plays a central role.

There are basically two schools of thought concerning the impact of rising oil prices on the U.S. dollar. Some observers note that the U.S. imports a relatively moderate amount of oil from OPEC countries as a percentage of total oil consumed: net oil imports accounted for 46% of total oil consumed in the U.S. in 1978, compared to 96% in West Germany and an even higher percentage in Japan and Switzerland.1/ Therefore, higher imported oil prices tend to have relatively less inflationary impact in the U.S. than in such other countries.

Another school of thought emphasizes the U.S.' limited capacity to implement effective policies to deal with the problems of inadequate energy resources and rapidly rising inflation. Foreign investors are primarily concerned with the longer-term outlook for the dollar; therefore, present levels of oil consumption are probably less important in creating expectations about the dollar than policies intended to alter these levels in the foreseeable future.

The widespread lack of confidence in this nation's energy program goes a long way in explaining the lack of enthusiasm with which U.S. dollar-denominated instruments were generally regarded during the second quarter of 1979. This pessimistic assessment explains the lukewarm response by foreign investors to indications of near-term dollar strength.

The U.S. trade deficit amounted to $6.6 billion during the second quarter, a larger figure than anticipated. Meanwhile, real GNP, seasonally adjusted, fell at a rate of 3.3% during the second quarter. Over the same period, corporate profits rose 19.6%, as compared to a 37% increase during the first quarter of 1979.2/ This slowdown in economic activity was apparent as the second quarter progressed through diminishing consumer credit demand and other

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1/ See OECD Economic Outlook, July 1979, p. 64.

2/ See The Wall Street Journal, July 26, 1979, p. 1.

early economic indicators released on a monthly basis. A slowdown has the effect of reducing the demand for both imports and domestically produced goods; thus, an improvement in the U.S. trade balance and inflation outlook was indicated over the near term.

The dollar was fairly strong in April, held its own in May and peaked in early June before falling sharply vis-a-vis other major currencies. It is likely that, as the June 25 meeting of OPEC ministers drew nearer, central governments intervened to bring the value of the dollar and, therefore, the real cost of oil, down. During the second quarter, the Japanese yen depreciated against the dollar, by almost 5%; in contrast, the British pound rose over 5% and the West German deutschmark and Swiss franc rose 1.6% and 2.2%, respectively.

Naturally, expectations concerning stock price movements are also a consideration in evaluating the potential gain from investing in the U.S. securities markets. During the second quarter of 1979, stock prices, as represented by the Dow Jones Industrial Average, the S&P 500 and the NYSE Composite Index rose 1.3% and 2.2%, respectively. Thus, there was no apparent clear-cut trend either attracting or discouraging foreign investment in U.S. equities.

QUARTERLY NET ACTIVITY

As can be seen from Table I, net purchases of U.S. equities by foreign investors fell 50%, from $684 million in the first quarter of 1979 to $342 million during the second quarter.

European Investors

European investors were net purchasers of $145 million of U.S. equities during the second quarter of 1979, a moderate decrease of 12% from the first quarter net purchase figure of $165 million. A large part of this decrease was accounted for by U.K. investors, whose net purchases fell from $230 million in the first quarter to $131 million in the second. If one compares the second quarter 1979 net purchases by U.K. investors to the average quarterly net purchase figure during 1978, $305 million, the decline is more dramatic. As noted earlier, the British pound appreciated over 5% vis-a-vis the dollar during the second quarter of 1979, making dollar-denominated investment vehicles considerably less attractive to U.K. investors than they were before the pound began its rapid ascent.

Swiss investors continued to reduce their net sales of U.S. equities, with net sales a marginal $2 million in the second quarter. West German investors, who sold the same amount of U.S. equities as they purchased in the first quarter, became net sellers of $75 million during the second quarter. Investors based in

France increased their net purchases of U.S. equities from $43 million in the first quarter of 1979 to $120 million in the second.

TABLE I

NET PURCHASES OF U.S. EQUITIES
($ Mils.)

	Second Quarter 1979	First Quarter 1979	Fourth Quarter 1978
Europe	$145	$165	$163
Belgium-Luxembourg	(4)	5	(18)
France	120	43	(41)
Germany	(75)	---	242
Netherlands	(32)	(70)	4
Switzerland	(2)	(29)	(299)
United Kingdom	131	230	199
Canada	101	58	66
Latin America	(25)	43	27
Bermuda	(15)	11	(1)
Netherlands Antilles	(21)	13	3
Asia	130	394	167
Hong Kong	16	19	8
"Other" Asia*	84	255	155
Total All Countries	$342	$684	$425

*Countries included are: Bahrain, Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia, the United Arab Emirates and other nations.

Source: U.S. Treasury

Asian Investors

During the first quarter of 1979, Asian investors accounted for almost 60% of total net purchases of U.S. equities by foreign investors. During the second quarter, Asian investors accounted for less than 40% of the total. Mideast oil exporting countries continued to reduce their net purchases; net purchases amounted to $84 million in the second quarter as compared to $255 million in the first quarter.

Since 1976, these investors have accounted for a steadily decreasing percentage of total net purchases of U.S. equities by foreign investors. In 1976, oil-exporting countries accounted for 65.5% of total net purchases by foreign investors; in 1977, 52.0% and in 1978, 32.4%. At the same time, net purchases of U.S. equities in absolute terms have consistently declined as well.

Japanese investors also reduced their net purchases, from $118 million during the first quarter of 1979 to $37 million in the second, despite the 5.2% depreciation of the yen vis-a-vis the dollar.

QUARTERLY GROSS ACTIVITY

In the first quarter of 1979, gross activity (purchases plus sales of U.S. equities) by foreign investors amounted to $8.7 bil-

Table II

GROSS TRANSACTIONS IN U.S. EQUITIES
($ Mils.)

	Second Quarter 1979	First Quarter 1979	Fourth Quarter 1978
Europe	$6,021	$5,203	$5,482
Belgium-Luxembourg	242	217	224
France	722	614	592
Germany	799	650	899
Netherlands	328	336	269
Switzerland	2,244	1,811	1,804
United Kingdom	1,471	1,340	1,385
Canada	1,351	1,128	1,022
Latin America	987	963	961
Bermuda	287	321	378
Netherlands Antil.	333	351	321
Asia	1,334	1,322	945
Hong Kong	200	173	226
Japan	297	236	128
"Other" Asia*	754	844	527
Total All Countries	$9,734	$8,688	$8,392

Source: U.S. Treasury

*Countries included are: Bahrain, Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates.

lion. During the second quarter, gross activity increased 12%, amounting to $9.7 billion. The ratio of purchases to sales, 1:14 in the first quarter, fell to 1:04 in the second. Thus, sales increased at a faster rate than purchases.

Swiss investors alone increased their gross activity by $433 million, or 24%, from the first quarter to the second, accounting for over 40% of the increase in aggregate gross activity by foreign investors in U.S. equities. Gross activity by French, German, British and Canadian investors also increased by $108 million, $149 million, $131 million and $223 million, respectively. Gross activity on the part of Asian and Latin American investors remained almost constant from the first quarter to the second quarter.

NET FOREIGN PURCHASES OF U.S. TREASURY BONDS AND NOTES

Foreign investors were net sellers of $34 million of U.S. Treasury bonds and notes during the second quarter of 1979, after purchasing net $1,126 million and $36 million in the fourth quarter of 1978 and the first quarter of 1979, respectively. Foreign investors as a group had been net buyers of U.S. Treasuries since the second quarter of 1978, when net sales amounted to $817 million.

Table III

($ Mils.)

NET FOREIGN PURCHASES AND TOTAL FOREIGN HOLDINGS OF U.S. TREASURY BONDS AND NOTES

	1979 Second Quarter		1979 First Quarter	
	Net Purch.	Holdings	Net Purch.	Holdings
Europe	$ 876	$16,898	$ 545	$16,022
United Kingdom	25	6,016	618	5,991
Asia	(385)	21,103	----	21,488
Japan	311	13,040	1,201	12,729
"Other" Asia*	(691)	7,433	(1,219)	8,124
All Countries	$ (34)	$43,345	$ 36	$43,379

Source: U.S. Treasury

*Countries included are: Bahrain, Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates.

Net purchases of U.S. Treasury bonds and notes on the part of European investors increased from $545 million in the first quarter of 1979 to $876 million in the second. U.K. investors reduced their net purchases of U.S. Treasury bonds and notes to $25 million, while West German investors increased their net purchases and Swiss investors became net purchasers after being net sellers during the first quarter of 1979.

Asian investors, after purchasing an equal amount of U.S. Treasury bonds and notes as they sold in the first quarter of 1979, were net sellers of $385 million in the second. While investors based in the oil-exporting countries reduced their net sales of U.S. Treasuries from $1,219 million in the first quarter to $691 million in the second, Japanese investors were decreasing their net purchases even more dramatically. Their net purchases of U.S. Treasury bonds and notes amounted to $1,201 million in the first quarter of 1979; in the second, net purchases plunged to $311 million.

NET PURCHASES OF U.S. CORPORATE BONDS

Net purchases of U.S. corporate bonds by foreign investors rose from $103 million in the first quarter of 1979 to $279 million in the second.

Table IV

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. CORPORATE BONDS
($ Mils.)

	Second Quarter 1979		First Quarter 1979		Fourth Quarter 1978	
	Gross	Net	Gross	Net	Gross	Net
Europe	$ 661	$ 69	$ 474	$ 54	$ 481	$ 85
Bel-Lux	36	(16)	64	(44)	25	(13)
Germany	99	33	84	54	53	3
Switzerland	146	(44)	110	30	117	57
United Kingdom	308	78	164	(4)	222	38
"Other" Asia*	457	71	478	(58)	455	121
Total All Countries	$1,637	$279	$1,299	$103	$1,348	$328

Source: U.S. Treasury

*Countries included are: Bahrain, Iran, Iraq, Kuwait, Oman, Qatar Saudi Arabia and the United Arab Emirates.

During the first quarter of 1979, U.K. investors were net sellers of $4 million of U.S. corporate bonds, in spite of a 13 basis point rise in interest rates on long term corporate bonds in the U.S. and the simultaneous fall of 91 basis points on equivalent issues in the U.K. In the second quarter, U.K. investors were net purchasers of $78 million of U.S. corporate bonds. Over this time, interest rates on these issues fell 23 basis points in the U.S. and rose 38 basis points in the U.K. This activity reflects the conclusion that interest rates in the U.S. would fall and the underlying value of outstanding bonds would appreciate.

Investments in U.S. corporate bonds by Mideast-based investors during the second quarter indicate a similar conclusion. After selling net $58 million of U.S. corporate bonds in the first quarter of 1979, Mideast investors became net purchasers of $71 million in the second quarter. While the second quarter 1979 net purchases of U.S. corporate bonds by U.K. investors were fairly consistent with 1978's net purchases, net purchases of these issues by Mideast investors during the second quarter of 1979 were low by 1978 standards.

NET PURCHASES OF FOREIGN STOCKS BY U.S. INVESTORS

According to data compiled by the U.S. Treasury, net purchases of foreign securities by U.S. investors fell from net purchases of $4 million in the first quarter to net sales of $62 million in the second quarter. Net sales of U.K., Canadian and Japanese securities by U.S. investors rose by $51 million, $33 million and $28 million, respectively, in the second quarter. In contrast, the first quarter of 1979 saw a substantial decrease in net sales of British securities from the previous quarter and a shift from net sales to net purchases of Canadian securities by U.S. investors (see Table V).

As we have attempted to explain shifts in capital flows from one country to another on the basis of potential profitability as determined by prevailing and projected economic conditions in each country, it is inconsistent that investors based in two countries would simultaneously be net sellers or net purchasers of the other country's securities. Similarly, one would not expect to find that investors in one country would be increasing net sales of securities issued in another country while investors in the other country were reducing net purchases of securities issued in the first country, and vice-versa. The data compiled by the Treasury Department concerning net sales by U.S. investors of foreign equities indicate such behavior. Moreover, the trends indicated by these statistics contradict the numerous articles appearing in various financial periodicals noting the present and anticipated increase in funds being invested overseas.3/ For these reasons,

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3/ See, for example, a series of articles on international investment of pension fund assets in Pensions and Investments, January 29, 1979 and "International Investing Boom Seen," and "Foreign Securities Expected to Draw Much More U.S. Pension Fund Money," Pensions and Investments, May 21, 1979, p. 12 and p. 30, respectively.

we continue to believe that the accuracy of the Treasury data on U.S. investment in foreign securities is suspect.

Table V

NET PURCHASES OF FOREIGN STOCKS BY U.S. INVESTORS
($ Mils.)

	Second Quarter 1979		First Quarter 1979		Fourth Quarter 1978	
	Gross	Net Purch.	Gross	Net Purch.	Gross	Net Purch.
Europe	$ 785	$(31)	$ 585	$(39)	$ 577	$ (29)
France	188	36	101	(13)	108	14
Netherlands	54	26	33	(1)	40	8
Switzerland	122	(12)	109	(1)	83	7
United Kingdom	343	(83)	288	(32)	267	(63)
Canada	1,214	22	631	55	501	(61)
Asia	480	(54)	364	(30)	513	(43)
Japan	409	(63)	317	(35)	456	(46)
Other	111	1	80	18	59	1
All Countries	$2,590	$(62)	$1,660	$ 4	$1,650	$(132)

Source: U.S. Treasury

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FOREIGN ACTIVITY IN U.S. SECURITIES

HIGHLIGHTS

1. Net purchases of U.S. equities continued to decline during the third quarter of 1979. This figure has plunged from $684 million in the first quarter to $352 million and $201 million during the second and third quarters, respectively.

2. Swiss and Mideast oil exporting countries continued to show less enthusiasm for U.S. equities. Net sales by Swiss intermediaries increased to over $200 million during the third quarter compared to only $1 million in the second quarter. Through the first nine months of 1979, the Mideast oil exporting nations were net purchasers of $433 million of U.S. stocks. This compares to $1,498 million, $1,061 million and $626 million in 1976, 1977 and 1978, respectively, for the first nine months of those years.

3. Foreign interest in U.S. Treasury bonds and notes changed dramatically from the second to the third quarter last year. Whereas foreigners were net sellers of $34 million during the second quarter, they were net buyers of $2,704 million in the third quarter. By buying large quantities of U.S. Treasury securities, the Swiss monetary authorities attempted to keep the Swiss franc from rising even faster.

4. U.S. investors were net buyers of $538 million of foreign stock during the third quarter of 1979. This interest in foreign equities represented a significant departure from the behavior reflected in data for earlier quarters and may be a harbinger of a trend predicted by many -- widespread U.S. interest in foreign securities.

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INTRODUCTION

Foreign investors substantially reduced their net purchases of U.S. equities during the third quarter of 1979. After purchasing net $352 million of U.S. equities during the second quarter of 1979, foreign investors reduced their net purchases to $201 million during the third quarter. Foreign investors were net sellers of $64 million of U.S. corporate bonds in the third quarter, as compared to net purchasers of $279 million in the second quarter. Net purchases of U.S. Treasury bonds and notes amounted to $2,704 million, a significant change from the second quarter's net sales of $34 million. The bulk of net purchases of U.S. Treasury bonds and notes was accounted for by official monetary authorities, indicating deliberate attempts to support the dollar by foreign central banks during the third quarter.

The U.S. balance of payments position went from a deficit of $1.1 billion during the second quarter to a surplus of $762 million in the third quarter. Generally, short-term interest rates rose faster in the U.S. during August and September than abroad. The Federal Reserve demonstrated its determination to continue to tighten credit with an increase in the discount rate on August 18th to 10% from 9.5% and again on September 19th, to 11%. Despite these developments, the dollar fared poorly in international exchange markets.

The Swiss franc and German mark appreciated 6.5% and 5.2% against the dollar, respectively, during the third quarter of 1979. The British pound rose a moderate 1%, while the Canadian dollar remained steady and the Japanese yen fell by another 3% during the third quarter, following a decline of 5% in the second. Gold topped $400 an ounce on September 28th, an indication of the extent of uncertainty regarding the future role of the dollar in the international monetary system (the Belgrade conference was scheduled to meet shortly).

The weakness of the dollar during the third quarter of 1979, particularly during the second half of September, prompted speculation as to the possibility of another dollar support program. However, decisive steps were not taken until October 6th. The measures included an additional hike in the discount rate to 12%, an 8% reserve requirement imposed on certain increases in deposit liabilities and a greater focus by the Federal Reserve on the supply of bank reserves rather than the traditional emphasis on the Federal Funds rate.1/

1/ See World Financial Markets, October 1979, p. 1, and "Dollar Surgery," The Economist, October 13, 1979, p. 7[illegible].

Inflation continued at an annual rate of over 13% during the third quarter, and remains among the primary causes of continued dollar weakness and a major deterrent to foreign investment in U.S. securities. While rates of inflation are increasing in most other industrialized countries as well, the increase in the U.S. is steeper compared to Japan and West Germany. Consumer prices rose 12.6% from month-end June to month-end September 1979 in the U.S., compared to an increase in the Japanese and West German consumer price indices of 4.4% and 3.1%, respectively.2/

In addition to exchange rate relationships, foreign investment in U.S. securities is linked to anticipated stock market trends. During the third quarter, the Dow Jones Industrial Average and the S&P 500 Index rose moderately, by 4.3% and 6.2%, respectively. Given the apparent strength of the U.S. economy during the third quarter, the stock market did not perform well. GNP grew at an annual rate of 2.4% in the third quarter, compared to a 2.3% drop in the second quarter. To some extent, this increase reflected the high profits reported by oil companies in the third quarter, as well as inflation.

QUARTERLY NET ACTIVITY

As can be seen from Table I, foreign investors reduced their net purchases of U.S. equities from $352 million in the second quarter to $201 million in the third, a reduction of slightly over 40%.

European Investors

European investors were net sellers of $197 million of U.S. equities during the third quarter of 1979, after purchasing net $145 million in the second. Over half of this swing from net purchases to net sales was accounted for by the huge jump in net sales of $202 million from Swiss investors. Furthermore, net purchases from France fell dramatically, from $120 million during the second quarter to $17 million during the third quarter. West German investors increased their net sales very moderately, from $76 million to $86 million. As noted earlier, the Swiss franc and the deutschmark appreciated significantly vis-a-vis the U.S. dollar, diminishing the potential profitability of investments in U.S. equities by many foreign investors. British investors reduced their net purchases of U.S. equities from $131 million to $104 million from the second to the third quarter of 1979.

2/ Business Conditions Digest, November 1979, p. 95.

TABLE I

NET TRANSACTIONS IN U.S. EQUITIES
($ Mils)

	First Quarter 1979	Second Quarter 1979	Third Quarter 1979
Europe	$149	$145	$(197)
Belgium-Luxembourg	4	(2)	(17)
France	43	120	17
Germany	---	(76)	(86)
Netherlands	(69)	(32)	5
Switzerland	(30)	(1)	(203)
United Kingdom	213	131	104
Canada	58	110	253
Latin America	45	(24)	20
Bermuda	12	(15)	(1)
Netherlands Antil.	13	(21)	15
Asia	411	128	131
Hong Kong	19	13	28
Japan	118	38	31
"Other" Asia *	272	83	78
Total All Countries	$684	$352	$201

Source: U.S. Treasury

* Countries included are: Bahrain, Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates

Asian Investors

Net purchases of U.S. equities by Asian investors remained almost constant from the second to the third quarter of 1979, amounting to $131 million in the third quarter. Investors based in Hong Kong increased their net purchases while Japanese investors and investors domiciled in the Mideast oil exporting countries reduced their net purchases moderately. Mideast investors have consistently reduced their net purchases of U.S. equities since 1976. Through September of 1976, net purchases of U.S. equities by investors based in the Mideast oil exporting countries amounted to $1,498 million; through September 1977, $1,061 million; through September 1978, $626 million. Net purchases in 1979 through September amounted to $433 million. Interest from the Mideast has been extremely modest beginning with the second quarter of 1979.

QUARTERLY GROSS ACTIVITY

From the second quarter to the third quarter of 1979, gross activity increased significantly, from $9.7 billion to $12.1 billion. Gross activity in the third quarter was also substantially higher than the quarterly average for 1978, which amounted to $9.5 billion.

TABLE II

GROSS TRANSACTIONS IN U.S. EQUITIES
($ Mils)

	First Quarter 1979	Second Quarter 1979	Third Quarter 1979
Europe	$5,203	$6,021	$7,341
Belgium-Luxembourg	217	242	291
France	614	722	735
Germany	650	299	996
Netherlands	336	328	401
Switzerland	1,811	2,244	2,874
United Kingdom	1,340	1,471	1,799
Canada	1,128	1,351	1,929
Latin America	963	987	1,115
Bermuda	321	287	303
Netherl. Antil.	351	333	367
Asia	1,322	1,334	1,645
Hong Kong	173	200	318
Japan	236	297	352
"Other" Asia *	844	754	886
Total All Countries	$8,688	$9,734	$12,098

Source: U.S. Treasury

* Countries included are: Bahrain, Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates

The largest increases in gross activity for individual European countries were accounted for by Switzerland, the United Kingdom and Germany. Swiss investors increased gross activity by $630 million; U.K. investors, by $328 million; and, German investors, by $697 million. Gross activity in U.S. equities by German investors has fluctuated significantly in 1979. In the first quarter, gross activity by German investors amounted to $650 million; in the second, this figure plunged to $299 million and in the third quarter of 1979, gross activity by German investors rose to $996 million.

Gross activity in U.S. equities by Canadian investors increased by $578 million from the second to the third quarter of 1979. Investors based in Hong Kong and the Mideast oil exporting countries together accounted for an increase in gross activity in U.S. equities of $250 million over the same time.

NET PURCHASES OF U.S. CORPORATE BONDS

Foreign investors were net sellers of $64 million of U.S. corporate bonds during the third quarter of 1979, a significant reduction from the $279 million of net purchases during the second quarter. European investors accounted for $209 million or slightly over 60% of the shift from net purchases to net sales of U.S. corporate bonds from the second to the third quarter of 1979. The Mideast oil exporting nations, including Bahrain, Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates, reduced their net purchases of U.S. corporate bonds from $71 million in the second quarter to $46 million in the third.

TABLE III

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. CORPORATE BONDS

	1979 Second Quarter		1979 Third Quarter	
	Net Purch.	Gross	Net Purch.	Gross
Europe	$69	$661	$(140)	$534
Bel-Lux	(16)	36	(22)	42
Germany	33	99	(41)	63
Switzerland	(44)	146	(1)	89
United Kingdom	78	308	(39)	269
"Other" Asia	71	457	46	298
All Countries	$279	$1,637	$(64)	$1,244

Source: U.S. Treasury

*Countries included are: Bahrain, Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates

On an individual country basis, West Germany and the United Kingdom accounted for the most substantial reductions. U.K.-based investors were net purchasers of $78 million in the second quarter of 1979 and net sellers of $39 million in the third; similarly, West German investors, net purchasers of $33 million of U.S. corporate bonds in the second quarter, became net sellers of $41 million in the third. This shift cannot be attributed to differential bond yields. During the third quarter of 1979, yields on long term domestic corporate bonds in the U.S. rose 55 basis points, while in the U.K. and West Germany, yields on such issues declined 12 basis points and 10 basis points, respectively.3/ Rather, the lack of enthusiasm for U.S. corporate bonds by these investors was probably attributable to the declining U.S. dollar.

FOREIGN INVESTMENT IN U.S. TREASURY BONDS AND NOTES

As shown in Table IV, foreign investors were net purchasers of $2,704 million of U.S. Treasuries in the third quarter of 1979, following net sales of $34 million in the second quarter. Foreign investors have been net buyers of U.S. Treasury bonds and notes since late 1974, with the exception of the second quarters of 1978 and 1979.

TABLE IV

NET FOREIGN PURCHASES AND TOTAL FOREIGN HOLDINGS OF U.S. TREASURY BONDS AND NOTES
($ Mils)

	1979 Second Quarter		1979 Third Quarter	
	Net Purch.	Holdings	Net Purch.	Holdings
Europe	$876	$16,898	$1,493	$18,391
Switzerland	46	379	914	1,293
West Germany	536	7,804	202	8,006
United Kingdom	25	6,016	178	6,194
Asia	(385)	21,103	(103)	21,000
Japan	310	13,039	(251)	12,788
"Other" Asia *	(634)	7,433	273	7,763
All Countries	$(34)	$43,345	$2,704	$46,049

Source: U.S. Treasury

* Countries included are: Bahrain, Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates

3/ See World Financial Markets, October 1979, p. 21

From the second quarter to the third quarter of 1979, U.K.-domiciled investors increased their net purchases by $152 million, West German investors by $202 million and Swiss investors by a dramatic $914 million. This dramatic increase may have been due to attempts to keep the Swiss franc from appreciating any faster than was actually taking place. Also noteworthy are Japanese investors' net sales of $251 million of U.S. Treasury bonds and notes. Japanese investors have been purchasing substantially less U.S. Treasuries in 1979 than in previous years. Such behavior is consistent with attempts to keep the yen from plunging even more against the dollar. In 1977 through September, Japanese investors were net purchasers of $2.9 billion of U.S. Treasury bonds and notes; in 1978 through September, $4.2 billion. In 1979 through September, net purchasers were down to only $1.3 billion. Almost all of these purchases can be attributed to the first quarter of 1979 when uncertainties about interruptions in oil supplies and sharp increases in oil prices were unanticipated and the yen was faring better in foreign exchange markets. Investors domiciled in the Mideast oil exporting countries, in contrast, were net purchasers of $245 million of U.S. Treasury bonds and notes during the third quarter of 1979. This category of investors had been net sellers on a quarterly basis since the first quarter of 1978.

NET PURCHASES OF FOREIGN STOCKS BY U.S. INVESTORS

U.S. investors were net purchasers of a significant amount of foreign stocks -- $538 million -- during the third quarter of 1979. Earlier Treasury Department data indicated that U.S. investors were either net sellers of foreign securities or very marginal net pur-

TABLE V

NET PURCHASES OF FOREIGN STOCKS BY U.S. INVESTORS
($ Mils)

	First Quarter 1979		Second Quarter 1979		Third Quarter 1979	
	Net Purch.	Gross	Net Purch.	Gross	Net Purch.	Gross
Europe	$(39)	$585	$(31)	$785	$86	$930
France	(13)	101	37	188	5	155
Netherlands	(1)	33	26	54	25	63
Switzerland	(1)	109	(12)	122	(8)	164
United Kingdom	(32)	288	(83)	343	4	422
Canada	55	631	22	1,214	444	1,330
Asia	(30)	364	(54)	480	--	316
Japan	(35)	317	(63)	409	16	244
Other	18	80	(1)	111	(18)	26
All Countries	$4	$1,660	$(62)	$2,590	$538	$2,694

Source: U.S. Treasury

* During September, over $40 million of stocks of companies located in Norway were purchased by U.S. investors.

chasers (first quarters of 1978 and 1979) until the third quarter of 1979. Such investment behavior was inconsistent with the belief that portfolio capital flows are largely reflective of prevailing and projected economic conditions and currency outlooks in different countries. The fact that U.S. investors were substantial net purchasers of foreign securities during the third quarter is more in line with projections made in our previous reports. The data still do not demonstrate a startling overall move into foreign securities by U.S. investors. Although U.S. investors shifted from net sellers of $62 million of foreign securities in the second quarter to net buyers of $538 million, $422 million or slightly less than 80% of this shift was due to acquiring Canadian equities. The Canadian stock market performed very well during 1979. The Toronto Stock Exchange 300-share Composite Index rose 37.7% from January 1 to October 5, 1979, following a 23.6% rise during 1978.4/

Nevertheless, the shift from net sellers to net buyers of European and Japanese stocks is consistent with our earlier statements and many reports in the financial press. The third quarter indications may be a harbinger of a future trend -- U.S. investors buying foreign securities. We will continue to monitor such developments closely.

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4/ See Barron's, January 7, 1980, p. 56

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Foreign Activity

AN ANALYSIS OF FOREIGN PARTICIPATION IN U. S. EQUITIES MARKETS
by the SIA Research Department

Volume III No. 1 April 4, 1980

FOREIGN ACTIVITY IN U.S. SECURITIES

HIGHLIGHTS

1. Net purchases of U.S. equities by foreigners in 1979 dropped to $1.6 billion from $2.4 billion in 1978. After reaching a high of $4.7 billion in 1975, net purchases of equities by foreigners have declined in every year since. Based on figures for the first nine months of 1979, net foreign purchases as a percentage of total net inflows could fall to its lowest level in five years, well under 15%.

2. Gross activity in the equities market by foreigners in the 1970-79 period has risen by about 152%, almost keeping pace with the 178% increase in daily average share volume on the NYSE.

3. Dramatic shifts in and out of U.S. Treasury bonds and notes are evident in the latter half of the year, as central banks tried to quell the pressures in the currency markets caused by political turmoil and the inflationary aftermath of oil price increases.

4. In 1979, U.S. investors made net purchases of $993 million of foreign stocks, compared with net sales of $527 million in 1978. U.S. purchases of Canadian securities were of particular note, escalating to $989 million in 1979 from $139 million in 1978.

5. Gross activity by U.S. investors in foreign securities has increased almost fivefold from $2 billion in 1970 to $10 billion in 1979. U.S. investors are not only buying more foreign equities recently, but they have become more active in trading such securities as well.

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INTRODUCTION

Currency Movements

Investor psychology is based largely on expectations, and the outlook for the dollar dominates expectations of foreign investors concerning U. S. corporate stocks. Generally thought to be oversold in 1978, the dollar began 1979 on favorable although tenuous ground. The defensive policy measures initiated by the Federal Reserve in November 1978 were in part responsible for renewed confidence in the dollar. In the first five months of 1979, net private capital flows into the U. S. exceeded $30 billion, or approximately double the net outflows during late 1978.1/

In early 1979, the temporary suspension of Iranian oil exports weighed heavily on market expectations. The early assessment of the political turmoil in Iran actually favored the dollar in two ways: The bidding up of spot oil prices generated additional dollar demand and the U. S. was viewed as being in a better position to cope with a short-term oil shortage than most other countries.2/ In addition, growth rates between the U. S. and other major industrial countries narrowed, while inflation rate differentials remained basically unchanged. Reflecting the improving picture for the U. S., net foreign purchases of equities in the first quarter of 1979 reached the high for the year, about $684 million.

The dollar was fairly strong in April, held its own in May, and peaked in June before falling sharply vis-à-vis other currencies. During this period concern grew over the effectiveness of U. S. policy to deal with rapidly rising inflation and a comprehensive energy program. Of major importance, U. S. banks cut their prime lending rates compared to other industrial countries; thus, interest rate differentials began to narrow. Second quarter foreign investment in U. S. equities fell to just over half the level reached in the first quarter.

Despite increasing improvement in the U. S. current account position and a rise in short-term interest rates, dollar weakness persisted in the third quarter. Inflation continued unabated, and the Federal Reserve upped the discount rate in August. Nevertheless, an uncertain atmosphere pervaded and gold began its astronomical climb. Third quarter purchases of U. S. equities dropped substantially to $201 million, the lowest quarterly amount for the year.

1/ World Financial Markets, November 1979, p. 2.

2/ "Treasury and Federal Reserve Foreign Exchange Operations", Federal Reserve Bulletin, September 1979, p. 721.

In October, the Federal Reserve initiated a series of policy measures aimed at strengthening the dollar and containing inflation. The dollar outlook improved somewhat, but in November the Iranian militants seized the U. S. embassy and later in the year the Soviet Union invaded Afghanistan. Overall, the dollar proved fairly resistant to this political chaos and an adverse economic environment. Fourth quarter net purchases were up 85% from the third quarter low, but were only 55% of the first quarter high.

From year-end 1978 to year-end 1979, the magnitude of currency changes vis-à-vis the dollar was slight compared to 1977-78. The dollar appreciated 21.6% against the Japanese yen, while depreciating 8.8% against the British pound and 5% against the German mark. Despite a high rate of inflation, the United Kingdom's relative energy independence kept the pound in a favorable position. While Germany is far more dependent on imported oil than the U. S., 96% versus 46%, other economic fundamentals including low inflation and unemployment kept the mark strong.3/ The rates of dollar depreciation against the Belgian franc, French franc, Swiss franc and Canadian dollar ranged from 3% to 1%.

Stock Prices

All of the major U. S. stock market indices increased notably in 1979 from year-end 1978 levels, with a jump of 64% in the performance of the AMEX Market Value Index. However, foreign investors generally concentrate their activity in the larger capitalized corporations represented by the DJI Average, the NYSE Common Stock Composite Index, and the S&P 500. While these indices increased 4.2%, 15.5%, and 12.3% over the year, respectively, the surge in the price of oil and inflation during late 1979 sent investors on a frantic search for ways to tie capital to hard assets instead of paper money.4/

FOREIGN ACTIVITY IN U.S. EQUITIES

Annual Net Activity

Gross foreign activity in the U. S. equity markets increased about 15% in 1979 from the 1978 level, rising to $43.5 billion from $37.9 billion. Net purchases, however, dropped to $1.6 billion from $2.4 billion. After reaching a high of $4.7 billion in 1975, net purchases of equities by foreigners have declined in every year since.

3/ "Germany: The Reluctant Ally", Business Week, March 3, 1980 p. 66.

4/ "Hot Seller: Bonds Indexed to Oil and Gold", Business Week, August 13, 1979, p. 74.

In 1979, four European countries were net sellers of U. S. equities -- Belgium, Luxembourg, Germany, the Netherlands, and Switzerland. In contrast, only two European countries were net sellers in 1978. The fall off in net purchases by European investors reflects primarily the swing to a negative outlook about the U. S. economy by German investors and the continued pessimistic outlook of Swiss intermediaries.

TABLE I

GROSS TRANSACTIONS IN AND NET PURCHASES OF U. S. EQUITIES
($ Mils.)

	1978		1979	
	Gross	Net	Gross	Net
Europe	$23,271	$1,283	$26,329	$ 216
Belgium-Luxembourg	978	10	1,018	(51)
France	2,808	47	2,811	122
Germany	3,609	620	2,753	(221)
Netherlands	1,336	(22)	1,488	(71)
Switzerland	7,871	(585)	9,804	(519)
United Kingdom	5,778	1,230	6,909	964
Canada	4,236	74	6,300	550
Latin America	4,259	151	4,527	(18)
Bermuda	1,744	70	1,405	22
Netherlands Antilles	1,418	8	1,581	(39)
Asia	5,846	968	6,028	863
Hong Kong	1,031	116	1,021	93
Japan	621	74	1,295	124
"Other Asia"*	3,887	781	3,372	656
Total All Countries	$37,865	$2,420	$43,452	$1,618

SOURCE: U. S. Treasury

*Countries included are: Bahrain, Iran, Iraq, Kuwait, Oman, Saudi Arabia, the United Arab Emirates.

European Investors

The bulk of most foreign activity in U. S. equities is accounted for by European investors. In 1979, net purchases fell by almost 85% from the 1978 figure, with 79% of the decline attributable to German investors, who made net sales of $221 million in 1979 compared with net purchases of $620 million in 1978. Relative to the other major industrial countries, Germany enjoyed sound economic growth over much of 1979. It was not until later in the year that evidence of a slowdown of the brisk German economy emerged, promoted by international developments as well as actions on the part of monetary officials.

Mideast Investors

Net purchases from the total Asia category were reduced a modest 11% in 1979, to $863 million from $968 million in 1978. The 1977-78 fall-off was a substantial 33.2%. The bulk of activity in this region originates in the oil-exporting countries, "Other Asia", which decreased their net purchases to $656 million in 1979 from $781 million in 1978. Japan, on the other hand, increased its net purchases by over two-thirds from 1978 to 1979.

Net Foreign Participation

Net foreign purchases of U. S. equities peaked in 1975, when foreigners accounted for 41.1% of the market. Since the peak, net foreign inflows have dwindled, ranging from 37% to 22% of total net purchases. Based on figures for the first nine months of 1979, the percentage of foreign purchases could fall to its lowest level in five years, well under 15%. Meanwhile, private pension funds significantly increased purchases in the first nine months of 1979.

TABLE II

FOREIGN PARTICIPATION COMPARED TO INSTITUTIONAL PARTICIPATION IN U. S. EQUITIES
($ millions)

Net Purchases by:	1970	1975	1976	1977	1978	9 mos. to 9/30/79
Private Pension Funds	$ 4,585	$ 5,714	$ 7,046	$ 4,522	$ 5,226	$ 9,550
Mutual Funds	1,225	(1,195)	(2,550)	(3,506)	(1,611)	(2,599)
Life Insurance Co.	1,795	1,152	2,024	500	(171)	(964)
Property-Liability Insurance Co.	890	(1,003)	610	650	1,584	802
State and Local Retirement Systems*	2,137	2,048	2,282	2,478	3,326	2,832
Foreign Investors	626	4,672	2,731	2,664	2,360	1,237
Total Net Inflows	11,258	11,394	12,165	7,308	10,714	10,858
Percent of Foreign Participation	5.6%	41.1%	22.6%	36.5%	22.0%	11.4%

SOURCES: SEC, U.S. Department of Commerce, and U.S. Treasury.
*Book Value

Annual Gross Activity

Annual gross activity by foreign investors in U. S. equities in 1979 reached a record high of $43.5 billion. While the 15% increase in gross activity in 1978-79 did not come close to the dramatic 48% increase in 1977-78, it closely parallels stock market volume. Daily average share volume on the NYSE increased 36% in 1977-78 and 12% in 1978-79. However, the increase in average volume is significant over the 1970-79 period, as is the trend of foreign participation in the market. Gross participation by foreigners has risen 152% since 1970, almost keeping pace with the 178% increase in daily average share volume on the NYSE. Daily average volume rose from 11.6 million shares in 1970 to 32.2 million in 1979; gross foreign activity increased from $17.2 billion to $43.5 billion.

With the exception of an almost 50% surge in activity by Canadian investors, gross activity in all geographic categories increased modestly in 1979. The percentage of increased activity from European investors receded sharply -- only 13% in 1979 compared with 50% in 1978. Of the five European countries increasing activity, Switzerland accounted for the lion's share, a 25% increase from last year's level. However, this increased activity was almost matched by a 24% decrease in activity by German investors. In the Asia category, gross activity by the Mideast oil-exporting countries dropped 13%, while Japanese investors more than doubled theirs.

For the past three years, the percentage of total foreign gross activity accounted for by Europe has remained virtually static at 61%. For 1979, the percentage of gross activity accounted for by Canada was 14%; by Latin America, 10%; and by Asia, 14%

Fourth Quarter Activity

Of particular note is the step up of net purchases by British investors to $495 million from $104 million. During the second half of the year the British government began to loosen its control over resident outflows, and in late October what remained of exchange controls was eliminated. Japan, on the other hand, initiated restraints on capital outflows. The Japanese authorities began to closely monitor foreign borrowing in the yen bond market as well as foreign currency lending on the part of Japanese banks and other financial institutions.5/ The Mideast oil-exporting countries significantly increased net purchases of U. S. equities to $224 million from $78 million in the third quarter.

5/ "Treasury and Federal Reserve Foreign Exchange Operations", Federal Reserve Bulletin, March 1980.

TABLE III

NET TRANSACTIONS IN U. S. EQUITIES
($ Millions)

	First Quarter 1979	Second Quarter 1979	Third Quarter 1979	Fourth Quarter 1979
Europe	$149	$145	$(197)	$ 98
Belgium-Luxembourg	4	(2)	(17)	(34)
France	43	120	17	(59)
Germany	---	(76)	(86)	(60)
Netherlands	(69)	(32)	5	28
Switzerland	(30)	(1)	(203)	(288)
United Kingdom	213	131	104	495
Canada	58	110	253	141
Latin America	45	(24)	20	(57)
Bermuda	12	(15)	(1)	26
Netherlands Antilles	13	(21)	15	(46)
Asia	411	128	131	191
Hong Kong	19	13	28	32
Japan	118	38	31	(62)
"Other Asia"*	272	83	78	224
Total All Countries	$684	$352	$201	$373

SOURCE: U. S. Treasury

* Countries included are: Bahrain, Iran, Iraq, Kuwait, Oman Qatar, Saudi Arabia and the United Arab Emirates.

NET PURCHASES OF U. S. TREASURY BONDS AND NOTES

Annual Activity

Net purchases by foreigners slid to $2.8 billion in 1979 from $4.7 billion in 1978. Net purchases in 1978 and 1979 were substantially below the 1977 figure of $22.8 billion.

The most significant turnaround in holdings of Treasury bonds and notes was made by the Japanese. Following net purchases of $4.7 billion in 1978, net sales of $353 million were made in 1979. While the Japanese were net purchasers during the first half of the year, the central bank's attempts to bolster the sinking yen vis-à-vis the dollar was evident in the third and fourth quarters.

The Swiss also made particularly dramatic shifts in and out of Treasury issues in 1979 to keep the franc relatively stable against the dollar. The considerable move by the United Kingdom from net sellers of $3.5 billion of Treasuries in 1978 to net purchasers of $863 million reflects efforts by the central bank to steady the appreciation of sterling. Britain's energy position and high interest rates pushed sterling up rapidly over the year.

TABLE IV

NET FOREIGN PURCHASES AND TOTAL FOREIGN HOLDINGS OF U. S. TREASURY BONDS AND NOTES
($ Millions)

	1978		1979	
	Net Purch.	Holdings	Net Purch.	Holdings
Europe	$1,541	$15,477	$4,078	$19,555
Switzerland	480	977	(312)	655
West Germany	3,942	7,110	2,880	9,990
United Kingdom	(3,515)	5,373	863	6,236
Asia	2,743	21,488	(1,684)	19,804
Japan	4,668	11,528	(353)	11,175
"Other Asia"	(1,884)	9,343	(1,172)	8,171
All Countries	$4,702	$43,343	$2,813	$46,156

SOURCE: U. S. Treasury

Fourth Quarter Activity

Fourth quarter net purchases by foreigners of U. S. Treasuries dropped to $49 million after the extraordinary spurt to $2.8 billion in the third quarter. The significant increase of $1.8 billion in net purchases by Germany reflects in part movements by the central bank to ease upward pressures on the mark. The political turmoil of the fourth quarter focused world attention on the mark, as considerable speculation developed that the mark would replace the dollar as the oil-pricing unit. On the other hand, the Swiss turned from net buyers of $914 million to net sellers of $628 million of Treasuries.

TABLE V

NET FOREIGN PURCHASES AND TOTAL FOREIGN HOLDINGS
OF U.S. TREASURY BONDS AND NOTES
($ Mils.)

	1st Qtr. 1979		2nd Qtr. 1979		3rd Qtr. 1979		4th Qtr. 1979	
	Net Purch.	Holdings	Net Purch.	Holdings	Net Purch.	Holdings	Net Purch.	Holdings
Europe	$ 545	$16,022	$876	$16,898	$1,551	$18,449	$1,106	$19,555
Switzerland	(643)	333	46	379	914	1,293	(628)	665
Germany	159	7,268	536	7,804	202	8,006	1,984	9,990
United Kingdom	618	5,991	25	6,016	177	6,193	43	6,236
Asia		21,488	(385)	21,103	(103)	21,000	(1,196)	19,804
Japan	1,201	12,729	310	13,039	(250)	12,789	(1,614)	11,175
"Other Asia"	(1,219)	8,124	(634)	7,433	245	7,678	493	8,171
All Countries	$ 36	$43,379	$(34)	$43,345	$2,762	$46,107	$ 49	$46,156

SOURCE: U. S. Treasury

NET PURCHASES OF U. S. CORPORATE BONDS

Annual Activity

Foreign net purchases of U. S. corporate bonds fell 41% from the 1978 figure, while gross activity increased minimally from $5.7 billion to $5.9 billion. While interest rates on long-term, U. S. corporate bonds rose 150 basis points over the year, this rise was almost matched or exceeded by long-term rates on corporate issues in other major industrial countries.6/ In addition, the uncertainties regarding the course of the U. S. economy intensified as the year progressed, and by year-end European investors were net sellers of $74 million of corporate bonds, compared with net purchases of $191 million in 1978.

TABLE VI

GROSS TRANSACTIONS IN AND NET PURCHASES OF
U. S. CORPORATE BONDS
($ Millions)

	1978		1979	
	Net	Gross	Net	Gross
Europe	$ 191	$2,243	$(74)	$2,236
Belgium-Lux.	(52)	164	(99)	171
Germany	64	330	42	286
Switzerland	(107)	693	(66)	464
United Kingdom	294	744	54	1,066
"Other Asia"	692	1,876	407	1,995
All Countries	$1,195	$5,723	$631	$5,917

SOURCE: U. S. Treasury

6/ Based on domestic long-term corporate bond yields as reported in World Financial Markets.

Foreign activity in U. S. corporate bonds continues to be discouraged by the up to 30% withholding tax imposed at the source on interest payments made to foreign investors. The tax, in effect, reduces the interest return by up to 30%. Long-term U. S. debt obligations, both corporate and government, are at a distinct competitive disadvantage with the Euro-dollar bond market.

Fourth Quarter Activity

Gross activity in U. S. corporate bonds by foreigners increased about 40% in the fourth quarter from the third quarter level, with foreigners purchasing $313 million net. In the third quarter, foreigners were net sellers of $64 million. The substantial increase in net purchases by oil-exporting countries from $46 million to $348 million accounted for this change, coupled with moderated net selling by European investors. While the yields on long-term corporate bonds rose a significant 105 basis points during the quarter, the unsteady position of the dollar made foreign investors reluctant to make long-term commitments.

TABLE VII

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. CORPORATE BONDS
($ Mils.)

	1st Qtr. 1979		2nd Qtr. 1979		3rd Qtr. 1979		4th Qtr. 1979	
	Net Purch.	Gross	Net Purch.	Gross	Net Purch.	Gross	Net Purch.	Gross
Europe	$ 54	$ 474	$ 69	$ 661	$(140)	$ 534	$(57)	$ 567
Belgium-Lux.	(44)	64	(16)	36	(22)	42	(17)	29
Germany	54	84	33	99	(41)	63	(4)	40
Switzerland	30	110	(44)	146	(1)	89	(51)	119
United Kingdom	(4)	164	78	308	(39)	269	19	325
"Other Asia"	(58)	478	71	457	46	298	348	762
Total All Countries	$103	$1,299	$279	$1,637	$ (64)	$1,244	$313	$1,737

SOURCE: U.S. Treasury

NET PURCHASES OF FOREIGN EQUITIES BY U. S. INVESTORS

Annual Activity

In 1979, U. S. investors made net purchases of $993 million of foreign stocks, compared with net sales of $527 million in 1978. A dramatic increase in net purchases of energy-related Canadian stocks was the primary cause for the swing, coupled with greatly reduced net selling of European and Asian equities. In the European category, U. S. investors were net purchasers of stocks of France and the Netherlands, but upped net selling of British equities. The overall gross activity spurted 47%, rising to $10 billion from $6.8 billion in 1978.

Based on a December 1978 to December 1979 change in stock price indices,7/ Canadian stock prices decisively outperformed those of other major industrialized countries, increasing about 51.5%. U. S. investors were attracted to Canadian equities to the tune of $989 million in 1979 from $139 million in 1978. In addition, Canada's abundance of natural resources made Canadian stocks quite attractive to investors in light of the energy dilemma facing other countries.

The turnabout in activity of U. S. investors in foreign securities from net sellers to net purchasers is in line with our projections of increased portfolio diversification by U. S. institutions. The 1979 net purchase figure is more than double the previous high for the 1970-79 period, $410 million reached in 1977. Moreover, gross activity has had an almost fivefold increase, from $2.0 billion in 1970 to $10.0 billion in 1979. However, we continue to believe that the Treasury figures understate the amount of U. S. activity and interest in foreign securities.

TABLE VIII

GROSS TRANSACTIONS IN AND
NET PURCHASES OF FOREIGN STOCKS BY U. S. INVESTORS
($ Millions)

	1978		1979*	
	Gross	Net	Gross	Net
Europe	$2,567	$ (333)	$3,250	$ (7)
France	366	(8)	605	4
Netherlands	248	(126)	225	81
Switzerland	450	(92)	608	(63)
United Kingdom	1,249	(61)	1,441	(169)
Canada	1,845	139	4,454	989
Asia	2,114	(364)	1,656	(27)
Japan	1,942	(376)	1,401	(24)
Other	279	31	656	38
All Countries	$6,805	$ (527)	$10,016	$ 993

* All 1979 net figures and the total gross figure for all countries are based on Treasury estimates using revised monthly data; gross figures are stated as originally reported on a monthly basis by the Treasury.

7/ Business Conditions Digest, February 1980, p. 96.

Fourth Quarter Activity

There was a slight increase of 7% in gross activity of U. S. investors in foreign stocks from the third to fourth quarter, continuing the gradual uptick that has been evident during the year. On a quarterly basis, net purchases declined 24% to $411 million.

U. S. investors became net sellers of European securities, with net Swiss sales of $43 million and net United Kingdom sales of $60 million accounting for the swing. These sales suggest that inflationary trends in these two countries weighed heavily on investment decisions.

TABLE IX

GROSS TRANSACTIONS IN AND NET PURCHASES OF FOREIGN STOCKS BY U.S. INVESTORS
($ Mils.)

	1st Qtr. 1979		2nd Qtr. 1979		3rd Qtr. 1979*		4th Qtr. 1979	
	Net Purch.	Gross	Net Purch.	Gross	Net Purch.	Gross	Net Purch.	Gross
Europe	$(39)	$ 585	$(31)	$ 785	$ 86	$ 930	$(56)	$ 950
France	(13)	101	37	188	5	155	5	161
Netherlands	(1)	33	26	54	25	63	33	75
Switzerland	(1)	109	(12)	122	(8)	164	(43)	213
United Kingdom	(32)	288	(83)	343	4	422	(60)	388
Canada	55	631	22	1,214	444	1,330	417	1,279
Asia	(30)	364	(54)	480	--	316	58	496
Japan	(35)	317	(63)	409	16	244	59	431
Other	18	80	(1)	111	(18)	26	(9)	160
All Countries	$ 4	$1,660	$(62)	$2,590	$538	$2,694	$411	$2,885

SOURCE: U.S. Treasury

* During September, over $40 million of stocks of companies located in Norway were purchased by U.S. investors.

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Foreign Activity

AN ANALYSIS OF FOREIGN PARTICIPATION IN U. S. EQUITIES MARKETS
by the SIA Research Department

Volume III No. 3 June 30, 1980

FOREIGN ACTIVITY IN U.S. SECURITIES

HIGHLIGHTS

1. Gross foreign activity in the U.S. equity markets reached a record level of $18.4 billion during the first quarter of 1980, 42% higher than the previous quarter.

2. Based mainly on the strength of the dollar, foreign net purchases of U.S. equities jumped substantially to $2.1 billion in the first quarter of 1980 from $373 million in the fourth quarter of 1979.

3. About 70% of total net purchases of equities originated in Europe. Together, Great Britain and Switzerland accounted for about 60% of total foreign net purchases and over 85% of net European purchases.

4. Foreign holdings of U.S. Treasury notes and bonds increased about 3% from year-end 1979 to month-end March 1980.

5. U.S. investors showed an impressive appetite for foreign equities in the first quarter of the year, with gross activity of $4.8 billion double that of the 1979 quarterly average of $2.4 billion. First quarter net purchases of $658 million were up about 60% from the fourth quarter figure of $411 million.

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INTRODUCTION

Expectations concerning future exchange rate levels, comparative rates of inflation, interest rate differentials and stock market performance are key determinants directing international portfolio capital flows. During the first quarter of 1980, the U.S. dollar was exceptionally strong, mainly because of widening interest rate differentials between the U.S. and other industrialized countries. Prompted by the need to reduce the rate of inflation, which approached 18% in the first quarter of this year, the Federal Reserve undertook a series of credit-tightening measures during February and March. Briefly, these measures included tightening U.S. money markets, a 1% increase in the discount rate, an increase from 8% to 10% on marginal reserve requirements on managed liabilities of large commercial banks and a series of restraints on consumer credit.1/

Interest rates continued to rise through March 1980, strengthening the U.S. dollar in foreign exchange markets. The dollar's appreciation took place despite a deepening trade deficit, from $6.9 billion in the fourth quarter of 1979 to $10.1 billion in the first quarter of 1980 and extensive intervention by central banks in foreign exchange markets to moderate the dollar's rise. From the last quarter of 1979 to the first quarter of 1980, the U.S. dollar appreciated 14.2% and 11.6% against the Swiss franc and the German mark, respectively.

With regard to inflation, the U.S. did not compare favorably with other industrialized countries except for the United Kingdom. Consumer prices in the U.S. increased 17.2% on an annualized basis during the first quarter of 1980, compared to a 10.7% increase in consumer prices in Japan, an 8.7% increase in West Germany and a striking 21.3% increase in the United Kingdom.2/

While the U.S. stock market indices were strong during the first month and a half of 1980, the falloff experienced during the remainder of the quarter pushed these indices below year-end 1979 levels. The brief boom was highly selective, limited largely to natural resource stocks -- oil and precious metals. On a comparative basis, however, the U.S. stock market did not fare exceptionally poorly. A combination of rising interest rates, coupled with disturbing signs that a simultaneous, worldwide recession such as occurred in 1974-75 might be in the offing, negatively impacted capital markets around the world.3/

On balance, investment in U.S. dollar denominated assets appeared favorable to foreign investors, as evidenced by the very substantial increase in net purchases of U.S. equities by foreign

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1/ See the Federal Reserve Bulletin, May 1980, "Domestic Financial Developments in the First Quarter of 1980."

2/ See Business Conditions Digest, May 1980, p. 95.

3/ See Barron's, April 21, 1980, p. 67: "Global Bear."

investors. During the fourth quarter of 1979, net purchases of U.S. equities by foreign investors amounted to $373 million; in the first quarter of 1980, net purchases by foreign investors soared to $2,100 million.

FOREIGN ACTIVITY IN U.S. EQUITIES

Quarterly Gross Activity

Gross foreign activity in the U.S. equity market reached a record level of $18.4 billion during the first quarter of 1980, 42% higher than the previous quarter. In comparison, during the same period, average daily share volume on the NYSE increased 37%. Thus, the volume of foreign activity rose as a percentage of total volume, with February activity particularly vigorous at $7.8 billion.

TABLE I

GROSS ACTIVITY IN AND NET PURCHASES OF U.S. EQUITIES
($ Millions)

	1979 Fourth Quarter		1980 First Quarter	
	Gross	Net	Gross	Net
Europe	$ 7,764	$ 98	$11,509	$1,475
Belgium-Luxembourg	268	(34)	367	(25)
France	740	(59)	1,263	155
Germany	808	(60)	1,376	62
Netherlands	423	28	486	(38)
Switzerland	2,875	(288)	4,603	493
United Kingdom	2,299	495	2,983	783
Canada	1,892	141	2,898	288
Latin America	1,462	(57)	1,706	80
Bermuda	494	26	650	(26)
Netherlands Antilles	530	(46)	449	39
Asia	1,727	191	2,177	257
Hong Kong	330	32	500	78
Japan	410	(62)	589	15
"Other Asia"*	888	224	962	162
Total All Countries	$12,932	$373	$18,372	$2,100

SOURCE: U.S. Treasury

*Countries included are: Bahrain, Iran, Iraq, Kuwait, Oman, Saudi Arabia, the United Arab Emirates.

Heightened activity came from nearly all geographic areas but was most pronounced in Europe, particularly in Switzerland. Most of the increase was due to buying fever, as is evidenced by the strikingly high net purchase figure for the quarter.

Quarterly Net Activity

Net purchases of U.S. securities by foreigners totaled $2.1 billion during the first quarter of 1980 (see Table I), over half of which was accounted for in February. About 70% of all net purchases originated in Europe. Together, Great Britain and Switzerland accounted for about 60% of total net foreign purchases and over 85% of net European purchases.

European Investors

At $1.5 billion, net European purchases were 15 times higher than in the previous quarter. While some European countries were net sellers during March, virtually all were large net buyers during February. Thus, while in the fourth quarter of 1979 four of the six European countries shown in Table I were net sellers, the reverse was true the following quarter. Only the Dutch showed a decline in net purchases of U.S. equities on a quarterly basis. In sharp contrast, the French, Germans and Swiss turned from net sellers during the fourth quarter of 1979 to important net purchasers during this year's first quarter.

Swiss investors put a dramatic end to seven consecutive quarters of net selling, becoming net buyers of $493 million for the quarter. The franc was under selling pressure due to high U.S. interest rates, a decline in the Swiss current account, and relatively high Swiss inflation. The Swiss government, atypically on the defensive, reversed its previous monetary policy by selling dollars, easing restrictions on capital inflows, and raising interest rates. While these measures may have contributed to the March net sales figure which dampened the effect of very high February purchases, it is likely that the predominant cause was the looming U.S. recession.

Germany's economic problems were similar to Switzerland's. A record $5 billion current-account deficit and an accelerating inflation rate helped to weaken the mark. German investors were net purchasers of $62 million of U.S. securities during the first quarter compared to net sales of $60 million during the last quarter of 1979. Much like in Switzerland, the central bank reacted with a major switch in monetary policy, loosening restrictions on capital imports.

British investors were net buyers of $783 million during the first quarter of 1980, compared to $495 million during last year's fourth quarter. While most foreign investors reduced or eliminated net purchases in March, U.K. investors maintained high net purchases of U.S. equities. Even discounting the lifting of British exchange controls in 1979, U.K. investors had good reason to behave differently from other European investors. Large British purchases were due not to high U.S. interest rates and a weakening pound

(indeed, the pound was strengthening), but to conflicting pressures on the U.K. government regarding economic policy. The damage the pound's strength was doing to Great Britain's balance-of-trade and export industries caused the government to pursue a policy of increasing monetary growth, while high inflation led many analysts and members of government to believe that the opposite policy was preferable. Thus, the signs in March that a U.S. recession and a lower dollar were in sight did not affect the British appetite for U.S. equities.

Canadian Investors

Canadian investors, like those in other countries, were attracted to the U.S. market during the first quarter of the new year. Net purchases doubled to $288 million from a net of $141 million during last year's fourth quarter. Canada placed third behind Switzerland and the United Kingdom in terms of net purchases of U.S. equities from any single country. Thus, not only have Americans shown increasing interest in acquiring Canadian stocks, but this interest appears to be a two-way street as Canadian investors are showing keener interest in U.S. equities as well.

Asian Investors

Higher net buying by Hong Kong investors and a move from net selling to net buying by Japanese investors pushed Asian net purchases of U.S. equities up 35% from the previous quarter to $257 million during the first quarter of 1980. Possibly as a reaction to the freezing of Iranian assets, investors from oil-exporting countries evidenced little enthusiasm for U.S. equities. Their net purchases for the first quarter were below those of the previous period, though still well above those for the second and third quarters of 1979.

After reaching a peak in 1975, the relative significance of Mideast oil-exporting countries in total foreign portfolio investment continues to decline. Nevertheless, this area of the world remains important in terms of potential funds flowing into U.S. equities and lagged behind only the United Kingdom, Switzerland and Canada in acquiring U.S. equities during the first quarter of 1980.

FOREIGN INVESTMENT IN U.S. TREASURY NOTES AND BONDS

Foreign holdings of U.S. Treasury notes and bonds increased about 3% from year-end 1979 to month-end March 1980. The significant increased buying of the oil-exporting countries from $493 million to $2.1 billion, and to a lesser extent of the United Kingdom, was responsible for the modest uptick in holdings given that most major industrialized countries were net sellers.

Treasury issues have been the traditional investment vehicle for the oil-exporting countries, and the rapid rise of rates, particularly in the one- to five-year maturity range, no doubt fostered the sharp escalation of buying. On a quarter-to-quarter

basis, particularly dramatic shifts can be noted as European central banks moved to stem the rapid rise of the dollar. On the whole, European countries reduced net purchases by 120%, swinging from net purchasers of $1.1 billion in fourth-quarter 1979 to net sellers of $264 million. Accounting for the majority of this change was the reversal of Germany's position as net buyers of $2.0 billion to net sellers of $616 million. Large sales of Treasuries were again reported by the Japanese, the yen having not recovered from its steep slide in 1979 against the dollar.

Toward year-end 1979, political turmoil prompted speculation that the German mark would replace the dollar as the oil-pricing unit. The substantial purchases of Treasuries in the fourth quarter of 1979 by Germany reflected in large part movements by the central bank to quell upward pressure on the mark. However, the political situation settled into the background as skyrocketing U.S. interest rates became the center of attention. Interest rate differentials widened in favor of the dollar and the lack of any significant softening of the U.S. economy put the mark, as well as the currency of other major industrial countries, under considerable downward pressure vis-à-vis the soaring dollar.

Most major countries experienced inflationary pressures and deteriorating current-account positions during the first quarter. Nevertheless, the rise of U.S. interest rates far surpassed that of other countries. The German central bank increased the discount rate by 1% in January and after the mid-February increase of the discount rate by the Federal Reserve Bank, the Swiss followed suit and the German discount rate was boosted another 1%.

TABLE II

NET FOREIGN PURCHASES AND TOTAL FOREIGN HOLDINGS OF U.S. TREASURY NOTES AND BONDS
($ Millions)

	1979 Fourth Quarter		1980 First Quarter	
	Net Purchases	Holdings	Net Purchases	Holdings
Europe	$1,106	$19,555	$ (264)	$19,291
Switzerland	(628)	665	(334)	331
West Germany	1,984	9,990	(616)	9,374
United Kingdom	43	6,236	757	6,993
Asia	(1,196)	19,804	586	20,390
Japan	(1,614)	11,175	(1,545)	9,630
"Other Asia"	493	8,171	2,050	10,221
All Countries	$ 49	$46,156	$1,521	$47,677

SOURCE: U.S. Treasury

These attempts to close the interest rate differential were viewed by some market observers as catch-up moves, and by others as the beginning of an interest rate war among major countries. The interest rate war failed to materialize, and the discount rate hikes proved largely ineffective in slowing the dollar's rise. The dollar was not about to lose its lustre until early April when interest rates peaked in the U.S.

NET PURCHASES OF U.S. CORPORATE BONDS

While gross activity by foreigners in U.S. corporate bonds moderated some 20% in the first quarter from the fourth-quarter level, net purchases at $337 million remained almost steady. There was, however, a distinct change in buying patterns. European countries made net purchases of $50 million, compared with net sales of $57 million in the fourth quarter. The oil-exporting countries, on the other hand, reduced their net purchases by 50%, from $348 million at year-end to $174 million. The large purchases in the fourth quarter by the oil-exporting countries represented the record level for the year and a significant departure from previous quarterly patterns.

TABLE III

GROSS ACTIVITY AND NET PURCHASES IN U.S. CORPORATE BONDS
($ Millions)

	1979 Fourth Quarter		1980 First Quarter	
	Net Purchases	Gross	Net Purchases	Gross
Europe	$(57)	$ 567	$ 50	$ 466
Belgium-Lux.	(17)	29	(28)	50
Germany	(4)	40	13	35
Switzerland	(51)	119	11	87
United Kingdom	19	325	25	235
"Other Asia"	348	762	174	600
Total All Countries	$313	$1,737	$337	$1,389

SOURCE: U.S. Treasury

An examination of monthly data shows net purchases by European countries of about $7 million in January and February. During these two months, record foreign participation was registered in U.S. equities and some of this enthusiasm carried over to corporate bonds. When European investors deserted the equity market in March, there was an almost four-fold increase in purchases of U.S. bonds. This increase represented an attempt to take advantage of

the high yields on corporate bonds. While corporate bond yields in almost every major country were on an upward path during the first quarter, no rise matched the 300 basis point increase of U.S. corporate bonds.4/

NET PURCHASES OF FOREIGN STOCKS BY U.S. INVESTORS

U.S. investors showed an impressive appetite for foreign equities in the first quarter of the year, with gross activity of $4.8 billion double that of the 1979 quarterly average of $2.4 billion. First quarter net purchases at $658 million were up 60% from the fourth quarter figure of $411 million. Large net purchases of securities of corporations based in France and the Netherlands resulted in converting a net sales figure of $56 million in the fourth quarter to net purchases of $129 million for companies domiciled in Europe. However, we suspect that the reported transactions in French securities are overstated and are canvassing the participating firms about our hunch. While there was a 60% increase in gross activity in Canadian securities, net purchases increased only about 10% to $461 million (see Table IV).

Transactions by U.S. investors in foreign securities suggest a continued strong interest in energy-related issues. For example, one Dutch holding company owns the majority interest of the second largest oil company in the world. Heightened activity was also reported in another Dutch company, Philips N.V., the majority owner of the largest non-American manufacturer of electronic equipment. Although the quarterly figure shows relatively high net purchases of Canadian securities, on a monthly basis net sales of $46 million were reported in March. The tapering off of enthusiasm for Canadian resource stocks may reflect a pause by investors to assess the implications of the change in government and the commercial potential of new oil finds.

Heavy portfolio diversification is evident in the first two months of the year, with minimal purchases made in March. Many variables, such as currency fluctuations, political risk, and regulatory restrictions, come into play when considering foreign investment. The trend toward stepped up participation in foreign markets by U.S. investors during the first quarter suggests that some U.S. portfolio managers are starting to believe that they can increase returns and/or reduce risk by diversifying into foreign markets.

4/ Based on domestic long-term yields as reported in World Financial Markets.

TABLE IV

GROSS ACTIVITY AND NET PURCHASES OF FOREIGN STOCKS BY U.S. INVESTORS
($ Millions)

	1979 Fourth Quarter		1980 First Quarter	
	Net Purchases	Gross	Net Purchases	Gross
Europe	$ (56)	$ 950	$129	$1,829
France	5	161	106	294
Netherlands	33	75	113	161
Switzerland	(43)	213	(34)	442
United Kingdom	(60)	388	(10)	650
Canada	417	1,279	461	2,099
Asia	58	496	49	663
Japan	59	431	20	512
Other	(9)	160	19	251
All Countries	$ 411	$2,885	$658	$4,842

SOURCE: U.S. Treasury

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Foreign Activity

AN ANALYSIS OF FOREIGN PARTICIPATION IN U. S. EQUITIES MARKETS
by the SIA Research Department

Volume III No. 5 September 30, 1980

FOREIGN ACTIVITY IN U.S. SECURITIES

HIGHLIGHTS

1. In the second quarter, despite a rising stock market, foreign investors approached U.S. equities with caution because of the dollar's weakness and the uncertainty over the length and depth of the U.S. recession. Net foreign purchases of U.S. equities plunged 80% to $408 million in the second quarter from the record high of $2.1 billion reached in the first quarter.

2. Gross foreign activity in the U.S. equity market dropped 32% from the first quarter record level of $18.4 billion to $12.5 billion. By geographic region, the decline ranged from 37% for European investors to 16% for Asian investors.

3. The oil-exporting countries escalated net purchases of Treasury notes and bonds sharply in the first quarter of the year. This heightened level of interest persisted, with net purchases of $2.5 billion recorded in the second quarter. Once again, the deep and liquid markets for U.S. Treasury issues provided an outlet for some of the huge balance of payments surpluses enjoyed by several oil-exporting nations.

4. Net foreign purchases of U.S. corporate bonds made a 2.3 time jump to $1.1 billion in the second quarter. As foreign investors deserted the equity market, they turned to the bond market in an attempt to capture attractive yields, which forecasters projected would not be available later in the year.

5. Despite the drop off in U.S. net purchases of foreign equities, these capital outflows still exceeded foreign net purchases of U.S. securities. With the exception of the third and fourth quarters of 1979, foreign interest in U.S. equities usually far surpasses U.S. investor interest in foreign securities.

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INTRODUCTION

The relative strength of the dollar is a major factor in evaluating the desirability of investment in U.S. equities by foreign investors. The fate of the dollar, in turn, rests on a mix of prospects for the U.S. economy, comparative rates of inflation and interest rate differentials among countries. The stellar performance of the dollar in the first quarter brought foreign investment in U.S. equities to record levels. So too, as the dollar began to lose its luster in the second quarter, foreign investors stepped back to reaccess U.S. equities as an investment vehicle.

With the beginning of the second quarter the contraction of economic activity in the U.S. was officially recognized as a recession and postdated to January 1980. The unprecedented climb of interest rates since the start of the year came to an abrupt halt as the demand for money and credit dropped off. By the end of June the prime rate had fallen to 11.5% after reaching an all-time high of 20% on April 2. The rapid descent of U.S. interest rates was a major factor precipitating the weakness of the dollar in the foreign exchange markets. Also contributing to the dollar's ills were the economic uncertainties that accompany a recession and the continuing political tension over the Iranian hostage situation.

Real GNP in the second quarter plunged at a steep 9.6% annual rate, giving rise to much speculation about the depth and length of the U.S. recession. The acute GNP drop was the cumulation of the unusual synchronization in the rates of decline of domestic final demand resulting from a combination of restrictive monetary policy, skyrocketing rates of interest, the imposition of credit controls, and soaring inflation in the first quarter.[1/] With evidence that the inordinate use of credit was subsiding and some progress was being made against inflation, the Federal Reserve began to dismantle the credit controls imposed in March, removing some in May and completely ending the program in July.

The lag time between the onsets of the U.S. and European recessions has allowed European central banks to maintain relatively high discount rates thus propping up their currencies against the dollar. In addition, while there has been a reduction of money market rates in most industrial countries, the decline has been gradual and slight in comparison with the plummeting of interest rates in the U.S. during the second quarter.

On a quarterly basis, a review of the trends of inflation among the major industrial countries indicates that inflationary pressures were reduced in the U.S. and West Germany in the second quarter.[2/]

1/ Economic Week, Citibank, N.A., July 28, 1980.

2/ Based on Consumer Price series of Business Conditions Digest, U.S. Department of Commerce, Bureau of Economic Analysis, July 1980, p.95.

The U.S. rate receded from the lofty annual pace of 17.4% to about 13.0%, while the West German rate ran at 6.2% compared to 8.7% in the first quarter. However, in the United Kingdom inflation remained at an unacceptable rate exceeding 21%. The pace of inflation picked up in Canada from 9.9% annually in the first quarter to 11.7% in the second quarter.

The sharpest monthly depreciation of the dollar during the second quarter occurred in April, with the steepest drop being 11.4% vis-à-vis the Swiss franc. Over the quarter, the dollar depreciated almost 14% against the Swiss franc and yen, about 11% against the German mark, and 9.4% against the pound sterling. In general, the dollar gave up much of its exceptional first-quarter strength.

Market performance indices climbed over the second quarter from the low March levels, recouping by the end of the second quarter most of the loss sustained since end-January. The NYSE Composite, the DJI, and the S&P 500 posted increases of 13.3%, 10.5%, and 11.9%, respectively. Moreover, these indices recorded gains in each month of the quarter. Despite a rising stock market, however, foreign investors approached U.S. equities with caution because of the dollar's weakness and uncertainty over the recession's length and depth.

Foreign Activity In U.S. Equities

Quarterly Gross Activity

Gross foreign activity in the U.S. equity market dropped 32% from the first-quarter record level of $18.4 billion to $12.5 billion in the second quarter. As can be expected, the drop in activity was particularly acute in April and May with a 27% rebound from those levels in June. The fall off in gross activity by geographic region ranged from 37% from European investors to 16% from Asian investors.

Quarterly Net Activity

Net foreign purchases of U.S. equities slid 80% from the record high $2.1 billion of the first quarter to $408 million in the second quarter. A lack of confidence in the U.S. economy was most evident in May, when activity from all countries resulted in net sales of $18 million. While the level of net purchases took a downturn in all regions during the quarter, European net purchases are still significantly higher than the 1979 average based mainly on the strength of British interest. Asian investors made the most dramatic quarterly swing, 112%, from net purchases of $257 million to net sellers of $31 million. The decline in net purchases by Canada and Latin America was also steep at 83% and 64%, respectively.

TABLE I

GROSS ACTIVITY IN AND NET PURCHASES OF U.S. EQUITIES
($ Millions)

	1980 First Quarter		1980 Second Quarter	
	Gross	Net	Gross	Net
Europe	$11,509	$1,475	$ 7,223	$ 352
Belgium-Luxembourg	367	(25)	254	33
France	1,263	155	691	46
Germany	1,376	62	625	12
Netherlands	486	(38)	416	(95)
Switzerland	4,603	493	2,597	(111)
United Kingdom	2,983	783	2,363	460
Canada	2,898	288	1,988	48
Latin America	1,706	80	1,429	29
Bermuda	650	(26)	606	2
Netherlands Antilles	449	39	412	21
Asia	2,177	257	1,836	(31)
Hong Kong	500	78	285	11
Japan	589	15	469	(76)
"Other Asia"*	962	162	1,014	44
Total All Countries	$18,372	$2,100	$12,539	$408

SOURCE: U.S. Treasury

* Countries included are: Bahrain, Iran, Iraq, Kuwait, Oman, Saudi Arabia, the United Arab Emirates.

European Investors

Net purchases by European investors at $352 million dropped 76% from the $1.5 billion of the first quarter, but are still running almost 3½ times the fourth-quarter 1979 figure. Accounting for the majority of net purchases was the United Kingdom, although net purchases at $460 million were down 41% from the $783 million recorded in the first quarter. In addition, the French dropped their level of buying 70% from $155 million to $46 million. The Swiss made the most pronounced shift from the first quarter, once again resuming their recent pattern of net selling. Swiss activity in the second quarter resulted in net sales of $111 million, in contrast to net purchases of $493 million in the first quarter.

British interest in U.S. securities has been kept at a relatively high level since the fourth quarter of 1979. At that time, net purchases jumped 2.3 times from the average of the three previous quarters. Influencing these capital outflows somewhat has been the lifting of British exchange controls. While Britain's oil position and high interest rates have put sterling in a favorable exchange rate position, the British economy is still in a state of stagflation. Wage rises have chased price rises across the 20% threshold at the expense of squeezing company profits and probably an investment slump.[3/] Consequently, although the pound maintained a strong position over the quarter vis-à-vis the deteriorating dollar, British interest in U.S. securities was only dampened. Moreover, second-quarter net purchases are just 7% below the fourth-quarter 1979 figure of $495 million.

First-quarter net purchases by the Swiss of $493 million were a distinct departure from a net selling pattern which had persisted for seven consecutive quarters. The franc was under considerable downward pressure during the first quarter, forcing the Swiss to reverse their previous monetary policies. Therefore, with the renewed strength of the franc over the quarter, the Swiss reverted to their previous investment pattern and sold $111 million of U.S. equities. In addition, the Swiss economy is now experiencing something of a capital spending boom, fueled by favorable cost conditions and the easy-money policy that grew out of exchange rate intervention.[4/]

3/ "OPEC cut wages -- or jobs," The Economist, April 26, 1980, p.58

4/ "Restrictive Policies Hold Back Recovery," Business Week, August 4, 1980, p.48.

Germany reduced net purchases in the second quarter to $12 million from $62 million in the first quarter. In comparison, however, Germany was a net seller of $221 million in 1979. The strength of the German economy and consequently the mark in 1979 was undermined by inflationary pressures and the deterioration of the current account position. The current account deficit continued to widen in the first quarter reaching nearly $14 billion at a seasonally adjusted annual rate. Exacerbating the current account position were the particularly heavy capital outflows experienced during the first quarter due to the attraction of high U.S. interest rates. While most central banks raised the discount rate during the first quarter, the Bundesbank was the only bank to hike the rate during the second quarter, from 7.0% to 7.5% in May. With the maintaining of relatively high interest rates while those in the U.S. were falling, capital flows began to return. On a monthly basis, net purchases were at low levels in April and May and net sales of $5 million were recorded in June, possibly indicating the beginning of a return to the net selling pattern of 1979.

Canadian Investors

Canadian net purchases of U.S. equities declined some 83% from the first-quarter level, slumping to $48 million by the end of the second quarter. Concern over the course of the U.S. economy, to which the Canadian economy is closely tied, made investors hesitant to continue activity at last year's pace. Events in the U.S. will be decisive for the external Canadian environment, affecting both exports and conditions under which domestic monetary policy will operate.[5/]

Asian Investors

Asian investors made net sales of $31 million of U.S. equities, compared with net purchases of $257 million in the first quarter. Second-quarter net sales represent a deviation from 1979 behavior, when Asian investors were net purchasers in every quarter.

Precipitating the majority of this turnaround were Japanese investors who swung from net purchasers of $15 million to net sellers of $76 million. The yen showed strong appreciation against the dollar over the quarter, based on favorable interest rate differentials and reported large capital inflows. Hong Kong investors and the oil-exporting countries reduced net purchases by 85% and 72%, respectively, from the first-quarter levels.

5/ OECD Economic Outlook, OECD, July 1980, p.102.

Foreign Investment in U.S. Treasury Notes & Bonds

As the dollar slumped and U.S. interest rates declined, net purchases of Treasury issues retreated to $136 million after a dramatic surge to $1.5 billion in the first quarter. Total foreign holdings remained almost stable. European activity resulted in net sales of $232 million, while large net purchases of $2.4 billion were recorded for Asian countries based on purchases by the oil-exporting countries.

The appreciation of European currencies vis-à-vis the dollar is reflected in the shifting of investment patterns from the first quarter. Switzerland made net purchases of $197 million in contrast to net sales of $334 million, and Germany reduced net selling to $513 million from $616 million. Both the Swiss and German central banks had to switch from their defensive postures of the first quarter, when the franc and mark came under considerable downward pressure. With the second-quarter flight from the dollar, the central banks intervened to moderate and steady upward pressure by buying more or selling less U.S. Treasuries to modify increases in their currencies.

The concerns of the United Kingdom are quite different from those of Switzerland or Germany. The primary goal of U.K. policy is to bring down the unacceptable pace of inflation. A strengthening of the pound, therefore, assists in this fight by lowering the cost of imports while increasing the price of exports. U.K. rates of interest have been maintained at very high levels and, with the plunge in U.S. rates, the differential between U.S. and U.K. issues became especially sharp. Over the second quarter, rates on U.S. Treasury bonds fell some 260 basis points while bill yields on a bond-equivalent basis dropped over 700 points. Consequently, the U.K. made a dramatic 99% reduction in net purchases, from $757 million to $8 million. Coupled with the attraction of high rates, the near term prospects for Britain's current and capital accounts point to a continued strong pound sterling.[6/]

In Asia, Japan had a significant reduction in net sales, from $1.5 billion to $85 million. Of the foreign currencies, the yen suffered the sharpest deterioration vis-à-vis the dollar during 1979 and early 1980. As this pressure has eased, less support intervention has been required by the Japanese central bank. The oil-exporting countries escalated purchases of Treasury issues sharply in the first quarter of the year to $2.1 billion. This heightened level of interest persists, with net purchases of $2.5 billion recorded for the second quarter. Once again, the deep and liquid market for U.S. Treasury issues provided an outlet for some of the huge balance of payments surpluses enjoyed by several oil-exporting nations.

6/ World Financial Markets, Morgan Guaranty Trust Company, July, 1980 p.5.

TABLE II

NET FOREIGN PURCHASES AND TOTAL FOREIGN HOLDINGS
OF U.S. TREASURY NOTES AND BONDS
($ Millions)

	1980 First Quarter		1980 Second Quarter	
	Net Purchases	Holdings	Net Purchases	Holdings
Europe	$ (264)	$19,291	$ (232)	$19,059
Switzerland	(334)	331	197	528
Germany	(616)	9,374	(513)	8,861
United Kingdom	757	6,993	8	7,001
Asia	586	20,390	2,361	22,751
Japan	(1,545)	9,630	(85)	9,545
"Other Asia"	2,050	10,221	2,508	12,729
All Countries	$1,521	$47,677	$ 136	$47,813

SOURCE: U.S. Treasury

Although not highlighted in the above table, the activities of international and regional agencies are a significant factor in the foreign activity in U.S. Treasury issues. These groups made net purchases of $1.0 billion in the first quarter and net sales of $2.1 billion in the second quarter which were consistent with interest rate trends and the strength of the dollar in the U.S.

Net Purchases of U.S. Corporate Bonds

Net purchases of U.S. corporate bonds made a 2.3 time jump to $1.1 billion in the second quarter, with gross activity stepped up 1.1 times from the first-quarter pace. As foreign investors deserted the equity market, they turned to the bond market in an attempt to capture attractive yields, which some forecasters projected would not be available later in the year.

Foreign interest was exceptionally strong in April, based partly on the fact that interest rates did not peak until the first week or so of the month. In addition, many new long-term issues carried relatively attractive rates. Net purchases in April totaled an impressive $474 million. With the drifting down of rates over the next two months, foreign interest began to diminish. European net purchases dropped to $104 million in May, compared with $232 million in April. Activity by the oil-exporting countries in May produced net sales of $26 million, in contrast to net purchases of $208 million in April, possibly reflecting the aftermath of the abortive U.S. mission to rescue the hostages. However, interest by the oil-exporting companies shot up to an exceptionally high level in June, with net purchases of $483 million recorded.

TABLE III

GROSS ACTIVITY AND NET PURCHASES IN U.S. CORPORATE BONDS
($ Millions)

	1980 First Quarter		1980 Second Quarter	
	Net Purchases	Gross	Net Purchases	Gross
Europe	$ 50	$ 466	$ 326	$1,364
Belgium-Lux.	(28)	50	(6)	118
Germany	13	35	197	395
Switzerland	11	87	89	157
United Kingdom	25	235	(10)	518
"Other Asia"	174	600	665	993
Total All Countries	$337	$1,389	$1,123	$2,929

SOURCE: U.S. Treasury

Net Purchases of Foreign Stocks by U.S. Investors

U.S. investors pulled back a bit from purchasing the equities of foreign companies during the second quarter. Gross activity and net purchases both dropped about 35% from the first-quarter level. Recessionary signals for most European economies caused an over 90% fall off in net purchases for that region from $129 million to $11 million. Sharp reductions in net purchases of 85% and 83% were recorded for companies headquartered in France and the Netherlands, respectively. In our first-quarter report, however, we stated that the high levels of net purchases of French securities appeared to be overstated. In canvassing reporting firms, this suspicion was confirmed. Moreover, there was stepped up net selling of British securities. However, a notable break from the net selling pattern of 1979 and first-quarter 1980 was the swing to net purchases of $14 million of Swiss equities. The appreciation of the franc, relatively good prospects for the Swiss economy, and the easing of capital inflow restrictions in the first quarter could have prompted this reversal.

Swiss securities were not the only recipients of increased U.S. attention. In another marked departure from previous quarters, net purchases of $170 million of Japanese equities were made. These purchases represented a 7.5 times increase from first-quarter purchases and net sales of $24 million in 1979. There are several reasons for the increased attractiveness of Japanese equities. As interest rate differentials shifted, yen deposits and Japanese securities gained favor, particularly from Mideast investors. Despite a widening current account deficit and a 99%-dependency on imported oil, the Japanese economy continues to have some positive offsetting economic prospects. Wage increases have been kept to a moderate 7%, compared with productivity gains of 12% in 1979. Average GNP growth in 1980 is expected to be down from the 6% rate of the past three years, but at over 4% is still high compared with growth rates of other industrial countries.[7/] In addition, several programs have been instituted to reduce oil-dependency and to promote exports.

U.S. investors have evidenced a substantial interest in Canadian securities, averaging net purchases of $440 million over the past three quarters. However, given the strong tie between the two economies, as the recession in the U.S. took shape, net purchases of Canadian securities dropped 53% to $217 million due to concern over the prospects for the Canadian economy.

7/ "Japan's buoyant equity market shrugs off economic woes," World Business Weekly, May 19, 1980, p.46

Despite the drop off in U.S. net purchases of foreign equities, these capital outflows still exceeded foreign net purchases of U.S. securities. With the exception of the third and fourth quarters of 1979, foreign interest in U.S. equities usually far surpasses U.S. investor interest in foreign securities.

TABLE IV

GROSS ACTIVITY AND NET PURCHASES OF FOREIGN STOCKS BY U.S. INVESTORS
($ Millions)

	1980 First Quarter		1980 Second Quarter	
	Net Purchases	Gross	Net Purchases	Gross
Europe	$129	$1,829	$ 11	$1,009
France	106	294	15	165
Netherlands	113	161	19	73
Switzerland	(34)	442	14	210
United Kingdom	(10)	650	(45)	445
Canada	461	2,099	217	1,291
Asia	49	663	175	597
Japan	20	512	170	524
"Other Asia"	19	251	(7)	9
All Countries	$658	$4,842	$427	$3,113

SOURCE: U.S. Treasury

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